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AGENDA ITEM 4a

TO: MEMBERS OF THE INVESTMENT POLICY SUBCOMMITTEE

I. SUBJECT: Revision of Core Principles of Accountable Corporate Governance

II. PROGRAM: Global Equity

III. RECOMMENDATION: Recommend to the Investment Committee approval of the revised statement of Core Principles of Accountable Corporate Governance

IV. ANALYSIS:

Executive Summary

Staff is recommending Investment Committee approval of two amendments to CalPERS' Core Principles of Accountable Corporate Governance ("Principles") as reflected in Attachment 1. Proposed amendments include:

1. An amendment to *Section A. Board Independence & Leadership* articulating greater clarity of the Investment Committee's preference for separate chair and CEO positions on the board of directors at portfolio companies.

2. An amendment to *Section F. Corporate Responsibility Principle 2* that recommends corporations to adopt environmental policies or objectives, such as those associated with climate change, to ensure sustainable long-term economic performance.

Board Independence & Leadership – Separation of Chair and CEO

Staff is recommending a revision to CalPERS' existing principles that is consistent with the Investment Committee's preference for separation of the chair and CEO positions on a board of directors, yet gives proxy voting Staff some flexibility in voting proxies. Staff's proposed revision is substantially in-line with the Council of Institutional Investors' position on this issue while consistent with external proxy advisory firms and other associations such as the International Corporate Governance Network, National Association of Corporate Directors, and Business Roundtable.

Staff's proposed revision is as follows:

- The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interest of shareowners, and it should name a lead independent director to fulfill duties that are consistent with those provided in Appendix B.

Going forward, Staff will review a shareowner proposal requesting the separation of CEO and chair positions on a case by case basis. Staff expects to review approximately 30 to 40 proposals each year based on trends[1] of this type of proposal being filed over the last four proxy seasons. When applying this amended principle to proxy voting, Staff will vote in favor of a shareowner proposal requesting the separation of the CEO and chair position on the board of directors reflecting CalPERS' preference for the split positions. However, there could be limited circumstances in which voting against such a proposal is in the best interests of a portfolio company and CalPERS as a shareowner in that company.

Staff will vote against a shareowner proposal only when the combination actually is in the best interests of shareowners with a disclosed counterbalancing board structure to ensure that the board can best perform its critical independent oversight function as well as act effectively and without conflict. Staff will evaluate the reasoning of the board of directors in each case where a proposal has been filed and the company continues to maintain a board structure with a combined position. At a minimum, when voting on a shareowner proposal to separate the CEO and chair positions, Staff will confirm the existence of two things before voting against the proposal:

[1] Trend data source: Institutional Shareholder Services ("ISS")

1) A written statement in the proxy materials discussing why the combination of the positions is in the best interests of shareowners.

2) Implementation of a board structure to counterbalance a combined CEO and Chair position to provide independent oversight and leadership without conflict which includes, at a minimum, the appointment of a lead director who is independent according to CalPERS' definition of independence.

Corporate Adoption of Environmental, Social and Governance Policies

As currently documented in CalPERS' Core Principles of Accountable Corporate Governance, the System believes that environmental issues can affect the performance of investment portfolios. Companies lacking policies, objectives or goals regarding environmental issues, such as those associated with climate change, could lose sight of the risks and opportunities facing them, thus leaving both the company and its shareowners' investments at risk.

The adoption and disclosure of environmental policies or objectives by companies can help keep management and directors focused on improving performance while ensuring sustainable long-term returns. Therefore, Staff recommends amending Core Principle 2 in Section F. – Corporate Responsibility to include reference to adopting environmental policies or objectives. Staff's recommended addition to CalPERS existing principle is italicized as follows:

- Section F. – Corporate Responsibility, Principle 2: To ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks and opportunities, *through adoption of policies or objectives*, such as those associated with climate change. Companies should apply the Global Framework for Climate Risk Disclosure (Appendix F) when providing such disclosure.

V. STRATEGIC PLAN:

This item is consistent with the Strategic Plan: Goal VIII to manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits, and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

There are no costs associated with this item.

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